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## ABSTRACT ECONOMICS ACCORDING TO SCHUMPETER

The very title of Dr. Schumpeter's new book, *Das Wesen und der Hauptinhalt der theoretischen Nationalökonomie*)<sup>1</sup> suggests that we have here something unique in German economic literature. A careful examination of the work carries the conviction that this is the very purest of "pure economics." No other writer has ever taken such pains to refine away from economic theory every trace of real life. Both man and nature are eliminated from the science, and pure assumptions bearing these names are substituted for them. According to Dr. Schumpeter's view, economists have sinned in attempting to be too profound. They have sought to ground their premises in philosophy, psychology, sociology, and other fields in which they are but dilettanti, and in which even the experts have found no firm footing. Hence the endless and fruitless controversies that have brought the name of economics into disrepute. A formal, contentless assumption is a far better premise for the science than the most brilliant philosophical generalization (pp. 26, 27). The economist who confines himself to the task of elaborating, by strict mathematical methods, all the conclusions that can be developed from a group of such premises is safe against refutation. True, the conclusions thus obtained are likely to have little to do with reality; they are capable of exciting only the mildest interest even in the mind of the specialist; and they are utterly devoid of practical importance. But, as the author wisely remarks, "wenn man schon Theorie betreibt, so muss man es so gründlich und korrekt wie möglich tun (p. 242)." This kind of theory will hardly become popular with American economists, perhaps because, though we have failed in our boyish ambitions to become President, we yet hope to write something that a president, a governor, or an alderman may read. No statesman will ever read Schumpeter.

The starting-point of Dr. Schumpeter's system is an individual possessed of given quantities of different economic goods, among which are classed the individual's own productive powers. The reader is carefully warned against supposing that "individual" is anything but an assumption, methodologically useful. "Goods" are purposely left undefined, so as to leave no ground for con-

<sup>1</sup> Leipzig: Duncker u. Humblot, 1908. 8vo, pp. xxxiii+626.

troversy. What is meant by "possess" is a nice question; in Schumpeter's scientific scheme it is a methodologically assumed relation, arbitrary, but useful. If the goods in the individual's possession are so related that a change in the value-magnitude of one involves a change in all the rest, we have the elements of a unitary system (p. 28). The individual, we will assume, strives so to rearrange his goods as to attain a (methodological) maximum of value. This maximum attained, we have before us a state of equilibrium, or static state (pp. 198, 199. The description of value relations in this state is the whole field of pure economics (pp. 37, 52). The reasoning developed in the treatment of the individual economy is applied without further ado to the social economy. And this in spite of the fact that the problems of distribution are to be illuminated by the investigation.

The reviewer can find no words to characterize properly the cautious deliberation with which Dr. Schumpeter leads up to his own positive contributions. At every step the question of methods is discussed, until the reader is abundantly convinced that the right one has been adopted. It may be said in passing that a more learned treatise on the methodology of economic theory can probably not be found. Many of the principles laid down deserve critical examination; we shall find it more profitable, however, to confine ourselves to a valuation of the chief fruits of the method adopted. These are: (1) a theory of value based upon utility alone; (2) a doctrine of imputation which abandons the task of distributing value product to the several agents participating in the work of production, and (3) a theory of distribution which recognizes only two forms of static income—wages and land return.

The pure economist is not allowed to know anything about the laws of want—for these fall within the province of psychology—nor about the law of diminishing returns—for this falls within the domains of agronomy and other technical sciences. How, then, is he to make his curves of demand and supply intersect so as to establish a definite value? Dr. Schumpeter's answer is a simple one. Ask the individual what he would give for one unit of a commodity; for a second; for a third, and so on. Thus we may establish a curve of demand having, we will assume, a downward trend. Substitute for "supply" the productive services in which it originates, and ask the owner of these services what he will take for one unit, for a second unit, and so on. Thus is established a supply curve having a trend

opposite to that of the demand curve, since each successive unit of productive agency is withdrawn, we assume, from a more important alternative use. On the basis of our assumptions we know that the two curves must intersect and a definite value must be established. And this is all that the pure economist knows about value. Other economists, it may be remarked, know that the various demand and supply curves have different shapes, and that these shapes take their character from influences originating in the fields that Dr. Schumpeter has warned us away from. And they also know that a large part of the value of economic theory is dependent upon its power to explain the varying forms of the demand and supply curves.

We may now examine Dr. Schumpeter's theory of imputation. Our author regards as futile all attempts to ascribe specific parts of the value product to specific factors in production. The utility functions of every product mirror themselves in the utility functions of every factor that participates in its production (p. 248). Ascribe the whole product to labor; then to land; then to the produced means of production. Of course if one adds the shares thus established he arrives at a wholly false result. But, asks Dr. Schumpeter, why should one attempt to add these shares?

It is to be noted that the examples employed by Dr. Schumpeter in his refutation of current theories of imputation are drawn from fields in which it would be generally agreed that solution of the problem is impossible. Thus, I wish to go to another city to effect a business deal which promises me 500 marks net profit. I signal a cab to take me to the station. If I could not get to the station except by means of this cab, the service it performs is worth at the utmost 500 marks. Similarly, the services of the railway in carrying me are worth a maximum of 500 marks; this is what I could afford to pay rather than fail of reaching my destination. It is sufficiently evident that no theory of imputation will account for the distribution of this net income among the several productive services from which it arises (pp. 246 ff.). Again, a number of distinct interests participate in building a railway. Each interest is essential to the success of the undertaking. The net return to the enterprise may all be imputed to any one of the interests; as a fact, any one, if strongly organized, may demand and secure the whole net return (p. 247). The reader cannot fail to observe that this discussion of imputation is entirely out of harmony with Dr. Schumpeter's general

method. It is only small variations that can be studied by static methods; static science is not concerned with the share imputable to all the laborers as a body, but with the share imputable to any one unit of labor. Pure economic theory fails utterly to explain the rates of wages that would be paid if all labor formed a compact organization.

It requires little space to state Dr. Schumpeter's theory of wages. For methodological purposes labor is to be treated as a commodity. In each use, labor has a descending curve of utility and an ascending curve of cost—the former representing the value of labor service in the use under discussion; the latter representing the value of it in alternative uses. Labor, therefore, has a price, and is subject to static analysis (pp. 330 ff.). This is perhaps no very startling discovery, but it is all that pure economics can tell us. The laws governing the price of labor in general are not discussed, probably because the author refuses to treat labor as a fund composed of homogeneous units. American economists are accustomed to employing static methods in the investigation of the effects of changes in the quantitative relations of labor and capital. Such an investigation presupposes the "funding" of labor; it also carries the investigator inevitably to a study of the law of diminishing returns. Accordingly there is a twofold reason why Schumpeter would exclude it from pure economics.

Rent is treated in the same manner as wages. The Ricardian analysis is rejected, instead of being made general, as in the system of Professor Clark. The theory of rent, our author claims, is nothing but the reverse side of the cost theory, and has absolutely no justification when that theory is abandoned (p. 61). Few economists can accept this view. Rather, the theory of rent rests upon a principle that has been forced upon our attention by the real world. This principle was originally confined by theorists to an unduly narrow field, whence arose many misconceptions. But the economist will gain little through ignoring the facts upon which the principle is based.

Interest, in Dr. Schumpeter's view, is not a static income at all; and failure to recognize this fact, he suggests, is a sufficient explanation of the diversity of opinions in this field (p. 390). The fundamental reason why there can be no interest is that the value of an instrument of production is derived from, and is equal to, the value of its services. This explanation of the value of instruments of

production Schumpeter ascribes to Böhm-Bawerk (pp. 387, 388); but do we not all know that Böhm-Bawerk inquires why the value of an instrument is *not* equal to that of its product, and arrives at the conclusion that this is because future services are discounted? That future services are not discounted in a static state, Schumpeter says, has been proven by Professor Clark. Thus, at last, Böhm-Bawerk and Clark have been reconciled—by cancellation.

The question naturally arises, What determines the value of land in a static state? Schumpeter hesitatingly accepts the view that land is valued according to the discounted value of its future services—a view totally out of harmony with his explanation of the value of other instruments of production (p. 375). He expresses doubt, however, whether land value should be discussed in static science. A static state precludes great changes. Now, the alienation of land represents an important change in the fortunes of an individual, and so should be excluded. This is a mere evasion of the issue; the sale of an acre of land is often no more important a change than the sale of a hundred bushels of wheat; the amount of wealth of an individual is not necessarily changed by the sale of land; it is merely the form of his wealth that is changed. Moreover, the land can be valued, even if no exchange of land against other goods is contemplated. Dr. Schumpeter's principle that there is no discount of the future in a static state leads inevitably to the conclusion that the value of land is infinite—and this would be a sufficient reason why it could not be exchanged. A corollary of the doctrine that interest is not a static phenomenon is the doctrine that the replacement of capital goods worn out in use is not a static phenomenon (pp. 394, 395). If it is true that in a static state an instrument yields no net return, there is no constant motive for reinvesting the proceeds from the use of an instrument in another instrument of the same kind. This is not the reason given by Schumpeter; but it is an entirely sufficient reason, while the ones given by the author are not. Take for instance, the statement that the replacement fund is part of a homogeneous income, and that it will be as difficult to invest one part of this income in a new machine as to invest another part (p. 395). Dr. Schumpeter, in a dynamic excursus (pp. 307–11), refuses to regard as income the net profits from which fortunes are constituted, because they fall beyond the customary standard of expenditure. Why assume, then, that a man regards his principal as income whenever he can succeed in laying hands upon it? Again,

it is said that investment in a new machine is a dynamic act; replacement of an existing machine does not differ fundamentally from investment in a new machine, and is therefore a dynamic act (pp. 394, 395). This consideration is obviously not worth discussing. Finally, a number of examples are given of "replacement" of capital which are really instances of the creation of new capital. A horse-car line is replaced by an electric line. Shipping capital is replaced by capital on dry land (pp. 421 ff.). These are obviously cases of dynamic disturbances: they have no bearing upon the questions whether a capital good does not normally earn enough to replace itself when worn out, and whether there is not some influence that normally leads the owners of capital to keep their funds intact.

Recognizing the fact that purely negative results always seem unsatisfactory even when valid, Dr. Schumpeter inserts the prolegomena to a dynamic theory of interest (p. 414 ff.). The center of the problem, he believes, is to be found in credit loans to new enterprises. The space given to this theory is insufficient for its adequate treatment; we must therefore reserve our judgment until the appearance of the book on interest which he promises to write in the near future.

Dr. Schumpeter's views on capital and interest are a sufficient indication that his "static state" comes very far from corresponding with the static state of Professor Clark's system. The latter is an ideal state of equilibrium; the former, a state that is inevitably approaching extinction through consumption of its funded wealth. This the author recognizes. It has seemed difficult to many American economists to discover any utility in studies of the static state in the sense in which Clark uses the term. What about studies of a static state which is an economic system decaying as an inevitable result of the principles of its existence?

The treatment of interest is, in the reviewer's opinion, the weakest part of this book. None the less it illustrates an admirable characteristic of its author: the courage to unfold all the consequences derivable from a given set of premises, even if the result may appear absurd. Premising that in a static state men ascribe to productive goods the undiscounted value of their future services, it follows of necessity that there can be no such phenomenon as interest. With equal certainty it follows that capital goods cannot be replaced in a static state. If this is true, a static state cannot be

what its name seems to signify, an ideal state of equilibrium, but a system plunging downward under an influence analogous to gravitation. Few economists would have the hardihood to present an argument leading to so absurd a result. Similarly, in abandoning the principle of diminishing returns, Schumpeter has renounced all possibility of handling such problems as a general law of wages or of rent. A close examination of his reasoning will show that the abandonment of diminishing returns and the law of wants has left his theory of value an almost meaningless formula. An economic system such as that which Schumpeter presents is one which affirms nothing: it is a system of no practical interest; it does not even promise anything in the way of interesting unrealities. The author must see that this is a consequence of the method which he adopts; but he clings nevertheless to his method. He makes economic theory commit hari-kiri—and with the maximum of pain, as anyone who reads these six hundred pages will testify—rather than accept succor from another field. As for the methodological principle which would confine each science absolutely to the facts originating in its own field, the reviewer would repudiate it utterly. It is not the nature of a fact but the consequences that flow from it, that determine whether a given science should take cognizance of it. Wants are facts of psychology, no doubt, but the purpose which a study of wants subserves may be economic. What psychologist considers the elasticity of wants as a phenomenon deserving minute study? This phenomenon derives almost its entire importance from its economic consequences. Similarly, the principle of diminishing returns would receive scant attention from any of the technical sciences in whose fields it operates. Its transcendent importance lies in the economic consequences that flow from it.

ALVIN S. JOHNSON

THE UNIVERSITY OF TEXAS